

Nordea

Nordea XCCY Publication

Q3-23 Outlook

Welcome to the Q3-23 XCCY publication!

Activity over the summer has been muted by limited issuance and scarce liquidity.

Heading into the September issuance season we are seeing a repeat of last year with quite a few issuances hitting the screens the last two weeks of August. However, the interbank has shown limited activity in Scandi XCCY despite a lot of issuers printing, as of late:

DB (EUR), KBN (EUR & USD), KI (EUR), KK (GBP), NDEA (EUR), Santander (NOK), SEB (EUR), SEK (EUR), SHB (EUR), SpareBank1 (EUR), Spires (NOK), Sydbank (EUR) & Volvo (EUR).

Issuance in EUR remains an attractive alternative for both Swedish and Norwegian issuers heading into the September issuance season; More so for Norwegian issuers. However, continued SSA interests keeps the curve steady around current levels.

Risk-on sentiment and ample supply of USD has elevated the EURUSD XCCY front at the start of summer and kept levels tight; Overall tightening and flattening the curve. €STR/Bor has likewise seen a further flattening into the summer; Overall we view the EE leg as less attractive in connection with basis, thus we would look vs. €STR.

Please be sure to check out our QuantPack for extended graphs and details regarding curve changes and rolls (link can be found in the e-markets article).

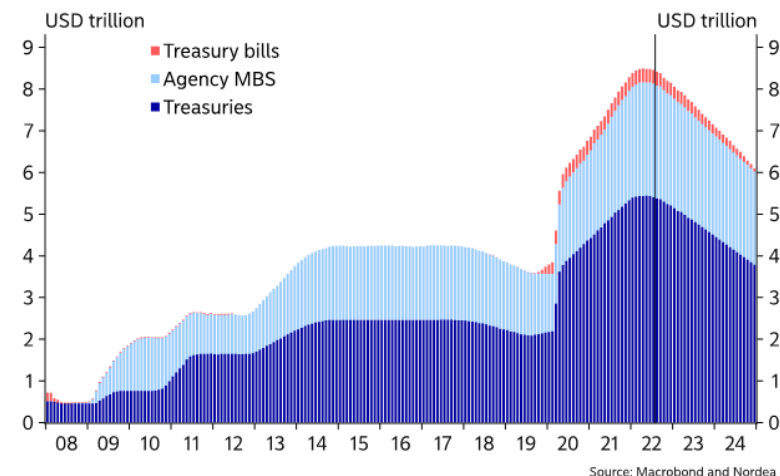
Enjoy the read!

EURUSD XCCY: Putting on insurance

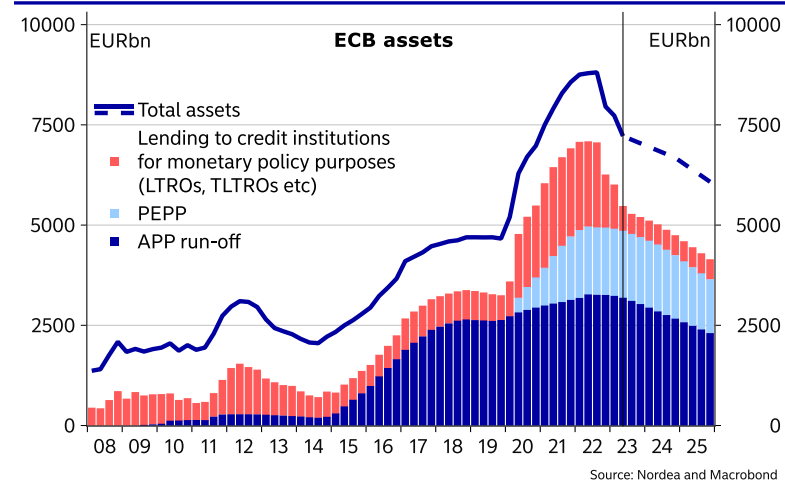
We prefer receiving EUR/USD basis

- **Dollar is king.** During the spring, we were all reminded how the macroeconomic environment and financial markets can turn on a dime. The stress in the regional banking sector came out of nowhere. The event also reminded us how investors scramble for USD when things go wrong.
- Over the summer, investors have reduced their probability of a US recession significantly, which has lifted stocks, pulled up interest rates, and tightened credit spreads. In the cross-currency universe, this has tightened and flattened the EURUSD XCCY basis curve.
- Looking ahead, we like to take advantage of the movements over the summer and put on risk-off hedges by receiving EURUSD XCCY basis and looking for a steeper curve. We think this makes a good risk/reward trade considering the current stage of the economic cycle compared to investors sanguine outlook as well as the outlook on liquidity in EUR versus the USD.
- **USD liquidity can quickly turn Scarce.** In the coming months, QT will run at a pace of around 75bn/m, while the US Treasury will increase its Treasury General Account (TGA) from its current level of 415bn to 650bn by end Q3 and 750bn by end Q4.
- Both factors will pressure USD liquidity. Unless money parked in the Reverse Repurchase (RRP) Facility absorbs these forces, USD liquidity can quickly become scarce. Fortunately, the Treasury will rebuild its TGA by issuing a lot of Treasury Bills, which are likely to lure out investors from the RRP facility.
- The struggle is that there is no certainty to this. If the RRP facility stays elevated, then QT and TGA rebuilding risks triggering USD liquidity scarcity by year-end.
- **EUR liquidity will be drained much slower.** In the coming months, The ECB will only reduce its balance sheet by allowing the Asset Purchase Program to run-off, which means that QT will run at a pace of around 30bn/m.
- There are still some TLTROs, which will expire in the future, but we think banks are likely to increase take-up at other ECB liquidity facilities, making the net impact close to zero. Overall, EUR liquidity is likely to be drained much slower than in the US.

Fed's assets will run-off at a moderate pace



ECB's assets will run-off very slowly

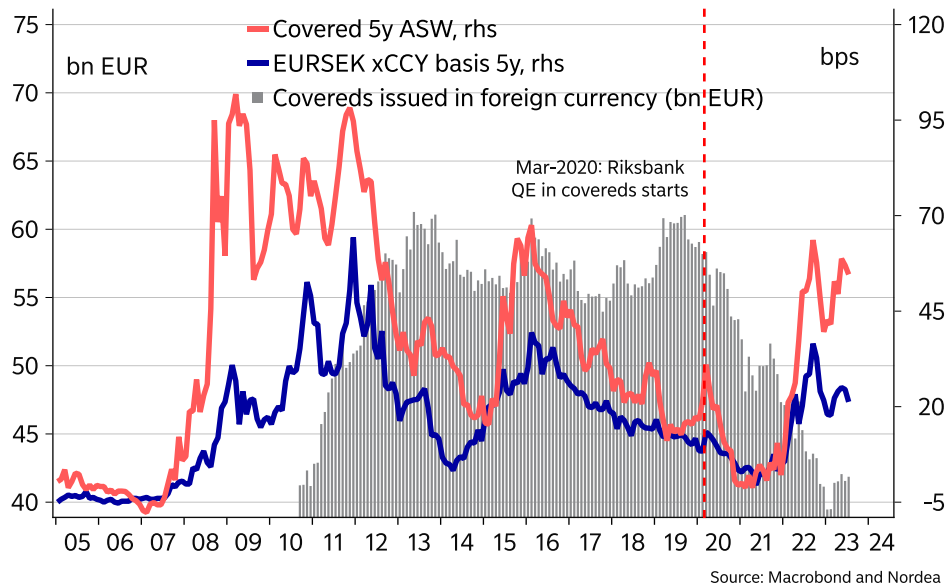


SEK XCCY: A risk-premium wrapped in a risk-premium

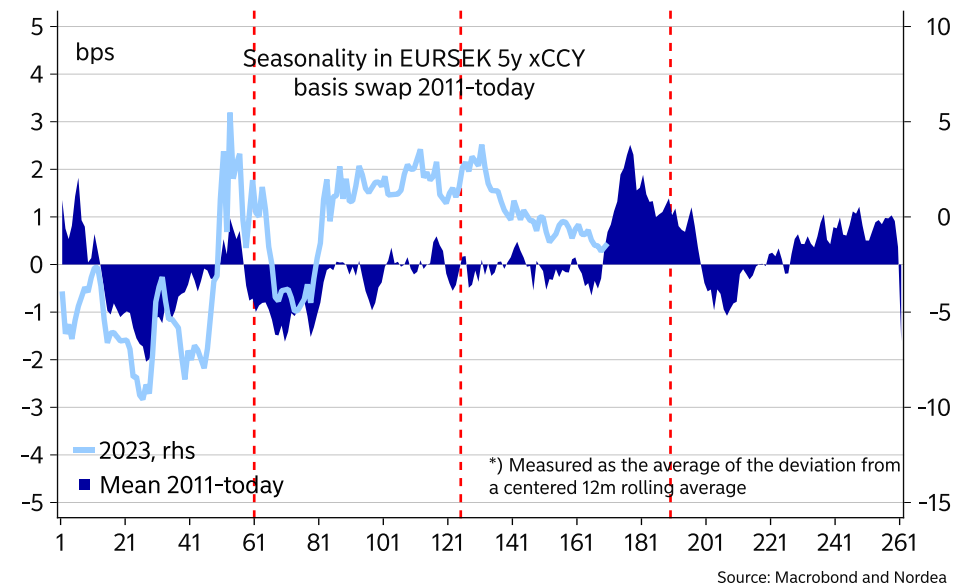
EURSEK basis curve offers roll-down as it reflects a risk-premium for domestic covereds

- One can in some aspects describe the SEK basis market as the “second derivative” of the SEK covered market. For example, if the domestic covered markets freezes with wide spreads, issuers will issue in Euro and swap to SEK. The EURSEK basis will widen as a consequence. The risk-premium in domestic covereds for wider spreads, financial turmoil, liquidity drainage etc. is also reflected in EURSEK basis.
- The covered ASW curve is steep and spreads are wide due to high bond yield volatility and housing market concerns. The rolldown in EURSEK basis is thus a way to exploit this particular risk-premium as well. In the near-term, with good global risk-appetite, covereds should do ok and the rolldown play in basis as well.
- Some drivers for wider basis spreads both near-term and on the horizon are however worth keeping in mind. Near-term, the issuance season has geared up. The seasonal pattern for EURSEK suggests some temporary widening. On the medium-term, some increase in Euro issuance from Swedish issuers may be on the cards. The Riksbank’s QE into SEK covereds depressed ASWs and trigger domestic issuance: with no QE purchases, foreign issuance may increase somewhat. At the same time, the decrease of FX issuance may also be a consequence of structural changes over time to banks’ preferred funding. The implication for the XCCY basis curve is inconclusive.
- In November and December, redemptions of bonds make the Riksbank’s excess liquidity decrease significantly. Indeed, during H2, around 140bn SEK will be off-printed. Less SEK liquidity will obviously mean less downward pressure on short-end basis spreads. (read more in “[The ~140bn QT Gorilla](#)”, 25 Aug)

EURSEK XCCY basis, domestic covered ASW and FX issuance



The seasonal pattern for EURSEK 5y XCCY basis

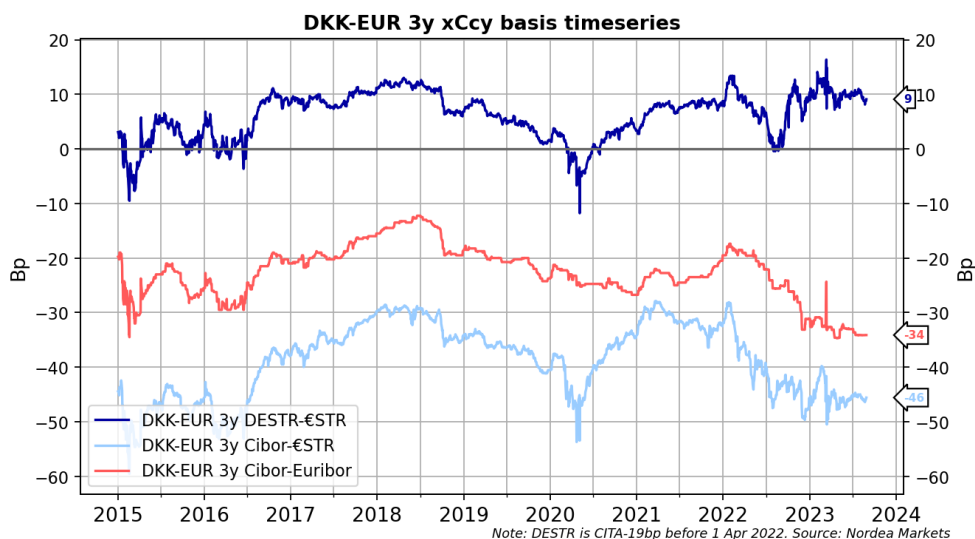


DKK XCCY: Steep DESTR/BOR

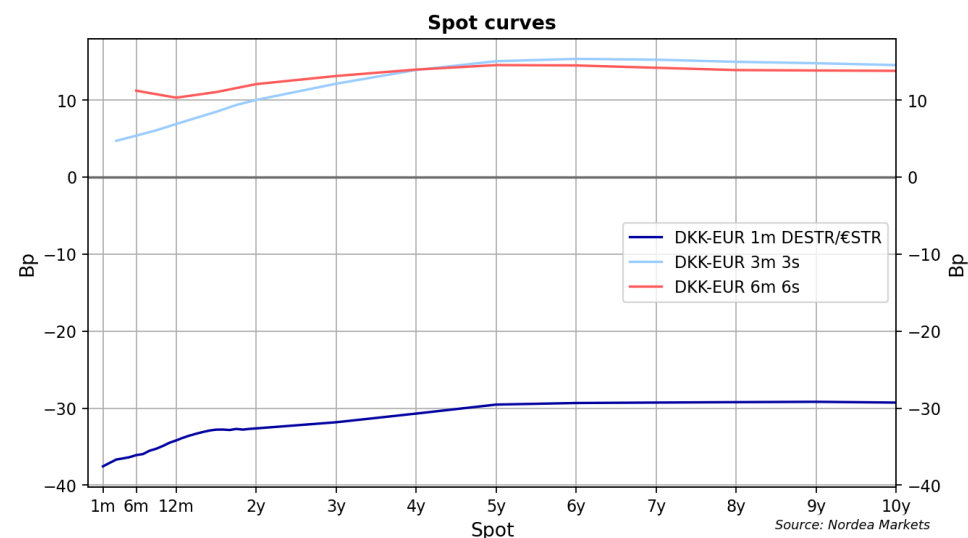
Issuance swapped back to DKK has been limited

- DKK liquidity remains ample with the central banks' net position with the banking system well above the 200bn-mark where front-end rates start moving higher in the central banks' interest rate corridor.
- The EURDKK FX spot remains much weaker than we had thought. A move towards previous intervention levels around 7.4360 is likely required before markets start pricing the risk of additional independent rate cuts, but that is far off. We do not believe the current implied forward curve will materialize with the risk of an independent rate hike priced. Flows support a stronger DKK and the central bank's reaction function is likely to be asymmetric, favoring more intervention before and independent rate hike should the FX spot rate weaken and little intervention before an independent rate cut should the FX spot rate strengthen.
- Pension funds' USD exposure increased significantly during summer with the rise in USD asset prices. Hedge ratios are roughly unchanged to slightly lower, implying a very modest increase in USD FX hedges.
- The DESTR/BOR curve is too steep. It is even steeper than the €STR/BOR curve, though Denmark has neither TLTROs to pay down nor QT. Paying interest to hedge Danish Covered Bullets could explain the steepness, but paying interest should quickly turn to DESTR or 6s with the 3s curve looking like this. We believe the steep DESTR/BOR implied forwards are unlikely to materialise.
- Issuance swapped back to DKK has been very limited of late; currently we see limited pickup in EUR, however, potential pickup through USD, GBP, SEK & NOK.

DKK-EUR 3y XCCY basis



DKK-EUR swap curves



Thank you!

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Nordea Bank Abp, Satamaradankatu 5, FI-00020 NORDEA, Finland, domicile Helsinki, Business ID 2858394-9
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